FinArc

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THE FINANCIAL NEWSLETTER OF FINARC, LLC

Mutual Funds and Independent Boards: How the SEC Recreated the Wheel

By W. David Malone, CFA

Recent scandals in the mutual fund industry forced the SEC (Securities & Exchange Commission) to take regulatory action at the mutual fund board level. A new SEC rule requires a mutual fund to have at least 75% of its directors, including the chairman, independent from the investment adviser. This change in board structure regulation will occur in December 2005. This is one of the most controversial changes that the SEC has ever made. Two of five commissioners of the SEC dissented on this rule and that is extremely rare. They cannot agree whether this will be beneficial for stockholders or create expensive redundancy and a disincentive to operate mutual funds.

SEC Commissioners Harvey Goldschmid, Roel Campos and SEC Chairman Bill Donaldson, all ardently support the new ruling. They believe making the Board independent will bolster investor confidence, protect fund investors, and, most importantly, eliminate conflicts of interest. The conflict of interest is the crux of their argument.

Imagine yourself the Chairman of a mutual fund board. You need to protect and work for the shareholders of the mutual fund. You also work for the company that manages and makes money running the mutual funds. The question of fee increases arises. A fee increase would be good for the company and you, but you must act in the best interest of the client, and increasing fees is not going to help your shareholders. Moreover, allowing large investors to do market timing in your in your funds

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Slaney Named Principal

Matthew C. Slaney has been named a Principal of FinArc. Matt, who is a portfolio manager with the firm, also provides analysis of the financial services, technology, and utilities industries.

News

Surabhi Mahapatra has joined the FinArc family as a part-time investment assistant. She is a graduate of McGill University, having earned a B.A. in Economics and Political Science. Surabhi has a passion for travel which has taken her to India, Thailand, Vietnam, Cambodia, Hong Kong and countries throughout Europe.

increases revenues for the firm, but may hurt small investors. The Chair of a mutual fund board who is working for investors and the mutual fund company, could be conflicted on certain issues. In the SEC's opinion, eliminating this potential conflict protects investors and boosts the integrity of all markets. Increased confidence encourages all investors to commit capital, which drives a positive shift in sentiment.

SEC Commissioners Cynthia Glassman and Paul Atkins side with Edward Johnson, head of Fidelity Investments and John Bogle, former leader of Vanguard Funds. They believe that since the customers are also investors they can vote against management without regulatory assistance. Under the new rule, control of the day-to-day management would be under an independent board member.

Imagine that you are an independent board member. One of your main concerns is how the funds are performing and operating with respect to the shareholder. If there is evidence that people running the fund are not doing well, you should change them to honor your duty to the shareholders. If the board, not the investment firm, has the power to take away control from those who manage the money, then a disincentive to operate mutual funds will exist. It is quite expensive and risky for management to create a mutual fund. A simpler solution already exists; investors sell their shares if they feel that the firm's activities or performance is not acceptable.

The dissenters believe there are not enough experienced personnel to replace the 80% of all mutual fund board Chairpersons who are not independent. A less knowledgeable, yet independent, board disadvantages investors. They believe that removing expert insiders might diminish the usefulness of the board. Additionally, funds with existing independent directors were allowing market timing and employee trading. Unfortunately, resolving the conflict of interest did not eliminate bad behavior.

The fallout from this decision is still to be determined. The cost of eliminating the conflict of interest is uncertain, but smaller funds, with limited resources, will be hurt the most. Moreover, internal political strife wears away at an investment manager's focus and that may have a larger impact on shareholder dollars. The few miscreants that create negative publicity for the industry make the honest fiduciaries and all investors pay for their misdeeds.

(News cont.)

The Boston Business Journal interviewed **Catherine White** about her advice for budding entrepreneurs. The June 18 article quoted her as saying that one of the biggest risks was underestimating the financial impact of normal economic cycles.

W. David Malone became a member of the Newton/Needham Chamber of Commerce. The Chamber's role is to promote civic interests and the general welfare of the community.

Matthew Slaney was interviewed on the topic of Socially Responsible Investing by Financial Planning Magazine. His comments appeared in the August issue in the article "A Matter of Opinion." Contact us if you would like a copy.

The September issue of Real Money, featured an article on **Matthew Slaney's** stock pick of Intuit. The article discussed the positive investment and corporate responsibility attributes of the company.

Catherine White served as a moderator at the Center for Women's Leadership Conference on October 15th. The topic "Starting A Journey: Entrepreneur Stories" was a forum for Helen Maslocka, of MedCool, Kip Holliston of Holliston Associates and Sofia Bapna, of Banjara Inc., to present their perspectives on the various stages of the entrepreneurial journey.

Advisory Board Spotlight

By Liv Nash, MBA

FinArc created its Advisory Board in November 2003 following Catherine White's recognition of its value through her directorship at Boston Federal Savings Bank. Boards offer outside perspectives from senior industry experts which can improve the way a firm operates. FinArc is proud to be in the position of benefiting from the experience and wisdom of its Advisory Board members. We would like to take the opportunity to introduce you to the members of our board. In this and following issues of Building Capital, we will highlight one member.

David Potter is a successful entrepreneur and turnaround operations manager. He is the founder and President of Momentum Venture Associates located in Providence, R.I. His firm customizes programs for entrepreneurs, guiding them to successful ventures. Dave received his undergraduate degree from Bowdoin College and his Master of Business Administration degree from The Amos Tuck School at Dartmouth College. He has served as Chief Marketing Officer and in key business development roles for several large companies, including UNUM Corporation where he created the first corporate marketing plan and was head of the Retirement Risk Relief Initiative Committee. The Committee was responsible for developing strategies to help customers have a secure retirement.

With a background in consumer marketing, Dave is familiar with what clients are looking for in a variety of industries, especially financial services. From operations to marketing, Dave advises his clients on how to broaden the base of their expertise on behalf of their companies' clients. Part of a company's success relies on the ability for the company to grow the capabilities of their employees, while recognizing the needs of their clients.

Mr. Potter believes that companies involved with client service must take the initiative in interacting with their clients; keeping them informed of why the company does what it does. In today's financial world, companies must provide more than just performance. They must also be proactive in their relationship with their clients and take a personal interest in their clients' successes. Dave believes that this is one of FinArc's many distinguishing attributes and a strength for its continued success.

When Dave isn't assisting growing companies in the Southern New England area, he enjoys playing tennis.

IRA Contributions for 2004 and 2005

If you haven't already made your 2004 IRA contributions, you still have until April 15, 2005. If you are planning on making a contribution for 2005, why not let those dollars begin growing tax-deferred as soon as possible and make that contribution now. Please contact Liv at *liv.nash@finarc.com* or 781-449-8989 if you are not sure if you are up to date with your contributions or if you would like to have the contributions made. Please see the back page for 2004 and 2005 contribution limits.

Community News

Catherine White volunteered her time to address students at the Academy of the Pacific Rim in Jamaica Plain about stock picking. She engaged the attendees in a look at Timberland, a proud sponsor of Boston's City Year Program.

Liv Nash will be participating in the Pan Mass Challenge in August, bicycling 89 miles from Wellesley to Bourne. Participants in the ride raise funds for the Dana Farber Cancer Institute. The Pan Mass Challenge raised over $20 million dollars last year for cancer research.

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Retirement Plan Contributions Limit Update

Plan	2004	2005
Traditional IRA/Roth IRA Catch-up contribution for age 50+	$3,000 $500	$4,000 $500
401(k) /403(b) /SEP Catch-up contribution for age 50+	$13,000 $3,000	$14,000 $4,000
SIMPLE plan Catch-up contribution for age 50+	$9,000 $1,500	$10,000 $2,000
Education IRA	$2,000	$2,000